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UNCLAS SECTION 01 OF 02 SANTIAGO 000915

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SUBJECT: UPDATE ON CHILE'S ECONOMY: OCTOBER 10 SEES CONTINUED FALL IN MARKETS

REF: SANTIAGO 909

¶11. (U) SUMMARY: This is the second in a series of reports on major developments in Chile's economy in the face of recent, global financial turmoil. On Friday, October 10, there were continued declines in the price of copper, Chile's exchange rate, and the stock market. Chile's private pension funds reported significant losses due to the financial crisis. Liquidity has remained stable in Chile's banking sector, due mostly to interventions by the Central Bank, but remains an issue of concern, especially as it affects lending to local small- and medium-sized enterprises. END SUMMARY.

Copper Prices Slump Again

¶12. (U) 3-month futures on the London Metals Exchange were down 11% on the day to \$2.14/pound. Copper was down 20% for the week, its lowest point since March 2006.

Chilean Peso Down vs. U.S. Dollar

¶13. (U) The Chilean Peso lost more ground against the U.S. Dollar, closing at 638 Chilean Pesos to 1 U.S. Dollar (down over 4%). The Peso has fallen 20% year-to-date and was at its lowest level against the Dollar in 4 years.

Stock Market Drops Again

¶14. (U) The IPSA index dropped again, losing more than 5% of its value from yesterday's close. The IPSA has dropped more than 20% this week.

Private Pension Funds Take A Big Hit

¶15. (U) Chile's Superintendency of Pension Fund Administrators announced that the nation's private pension funds had been impacted heavily by the effects of the global financial crisis. The "A Fund," the riskiest fund which invests in stocks, lost 11.8% of its value in the month of September alone.

Central Bank Holds Key Rates Steady

¶ 6. (U) The Central Bank announced it will keep interest rates at 8.25% (instead of raising them to fight inflation), in view of the global financial turmoil.

Central Bank Changes Reserve Requirements

¶ 7. (U) The Central Bank will temporarily allow Chilean banks to meet reserve requirements in currencies other than U.S. Dollars (e.g., Chilean peso).

Central Bank Focused On Maintaining Liquidity

¶ 8. (SBU) Contacts at the Central Bank told the Embassy that the Bank has formed a special committee to monitor international credit conditions. The Central Bank sees its principal role as assuring liquidity in the financial sector, and believes it has sufficient reserves to do that job. Liquidity is thought to be adequate at the moment, as can be seen in response to the Central Bank's offers of currency swaps. The terms of the swaps have been increased from 28 days to 180 days. In the first offering of \$500 million, only \$350 million was taken, and only \$30 million of the \$500 million was taken in the second offer.

Banking Superintendency Sees Adequate Liquidity

¶ 9. (SBU) Contacts at the Superintendency of Banks told the Embassy that liquidity is at "normal" levels (both in local and foreign currency) in the banking sector, given the current situation.

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Heads of Chilean banks met Wednesday, October 8, to assess sector conditions. The consensus was that there is no panic, but credit is tightening, and the Central Bank needs to assist in maintaining the current levels of liquidity.

Local Lending Worries Head of Banking Association

¶ 10. (SBU) In a conversation with Ambassador Simons, Hernan Somerville, President of Chile's private bank association said Chile's banks are well equipped on the liability side to withstand the crisis. International lines of credit are tightening somewhat but can be easily replenished from auctions of Central Bank reserves and, if needed, Chile's \$25 billion in sovereign wealth funds. Banks are pleased with the responsiveness thus far of Finance Minister Velasco and Central Bank President De Gregorio.

¶ 11. (SBU) Somerville was more worried about the asset side. If banks cut back too severely on credit lines to small/medium businesses and hoard cash, this could impact the real economy. He is trying to convince the banks to keep credit broadly available. The local stock market was falling in line with international trends. Somerville believed the U.S. needed to send a firmer signal on the bank rescue to stop the downward trend. Local stock market drops could eventually affect public support for Chile's privatized pension system as equity-rich funds had taken big hits. This could also motivate big family holders to buy back cheap equity, which would not be good for the depth of capital markets in Chile.

Local Bank Says Credit Tighter for Smaller Companies

¶ 12. (SBU) Contacts at BCI, a private Chilean bank, noted it was becoming quite difficult for small- to medium-size enterprises in the Chilean private sector to take out new loans (mostly because of heightened credit requirements). However, BCI was willing to renegotiate the terms of existing loans if these companies ran into trouble.

SIMONS